



DEPARTMENT OF STATE

Washington, D.C. 20520

October 24, 1983

~~UNCLASSIFIED~~
~~with CONFIDENTIAL Attachment~~

MEMORANDUM FOR MR. DAVID PICKFORD
DEPARTMENT OF THE TREASURY

Subject: Paper on US-EC Relations for the SIG/IEP

In response to Norman Bailey's request of September 12, 1983, we are transmitting, under cover of this memorandum, a paper on US-EC Relations.

A handwritten signature in cursive script, appearing to read "Charles Hill".

Charles Hill
Executive Secretary

Attachment: As stated

~~UNCLASSIFIED~~

CONFIDENTIAL

US-EC Relations

Introduction and Summary

The response of both the U.S. and the nations of the European Community to trade and economic disputes must be conditioned by our interests in the overall relationship between the U.S. and Western Europe. For both sides the priority of our interests necessarily places security above economic and political interests. If our security were to be weakened--and severe economic battles could cause such a weakening -- the effort to achieve and maintain a balanced relationship with the Soviet Union, both in Europe and beyond, would be jeopardized. More generally, the Europe of the Ten includes the greater part of that small number of nations in the world with which we are able to work intimately and productively in trying to maintain a liberal trading order and strengthen democratic forces throughout the world.

The responsibility to place our economic and commercial differences within this larger context applies on both sides of the Atlantic. Both we and the Europeans have to manage these differences as a whole, so that their solutions can also help reinforce our overall relationship. Neither should seek "solutions" to internal problems at the expense of the other.

On the theoretical level, such a recommendation appears self-evident and indeed represents a continuation of existing policy, or at least of a policy ideal acknowledged on both sides of the Atlantic. The reality has been different, and the effort to bring our relationship back to what we all agree it should be will require specific compromises on both sides. The question is how to begin.

European economic difficulties and, beyond them, generalized pessimism about the future, render the Ten more inward-looking and hence less mindful of objectives shared with us. The burden of taking the initiative on finding solutions capable of sustaining our relationship at this time therefore inevitably falls more on the United States. This means, as a first step, that we should ensure that our own policies toward Europe on specific economic issues are consistent with our overall interests; we can then encourage a corresponding approach in Europe.

Our approaches, both internally and externally, should take into account prevailing conditions in Europe, and the nature of the problems confronting us. These are discussed in the two sections which follow. Thereafter, there is a brief review of the importance of Europe to the United States which serves as a lead to our conclusions. These include specific initiatives necessary to deal with current issues under current conditions, prefaced by proposals for modification of current intra-USG approaches.

CONFIDENTIAL
DECL: OADR

CONFIDENTIAL

-2-

The Current Situation of the European Economy and Community Leadership

Economic disputes between the U.S. and the EC are nothing new. As with earlier disputes, many of the current arguments are likely either to be resolved to our mutual satisfaction, or at least acquiescence. Others may die down until some event rekindles interest: this may be true of the arguments over "extraterritoriality." However, it would be wrong to say that there are no differences between the current situation and past periods of US-EC strain. Two differences deserve particular attention.

First, there is a problem of who speaks for Europe--and who takes the responsibility for its economic relations with the U.S.

This is not a new problem. Ten years ago Secretary Kissinger raised it at length. But it has become more severe in recent years. The Commission of the European Communities, which has responsibility for proposing and executing Community policy in the trade area, has lost influence. Long-time observers of the Community agree that the powers of the Commission, and its leadership potential, are now at their historic nadir.

This is of consequence for our economic relations with the EC because we have, over the history of the EC, relied on the Commission to adopt positions that were more reflective of broad, global concerns than the narrower positions of some member states. In multilateral trade negotiations, for example, previous Commissions would go beyond their formal mandates in order to reach agreement with the U.S., accepting the political risk of seeking ex post approval by the member states.

The present Commission's performance in the current review of the CAP is evidence that it is no longer capable of such imaginative, bold, and outward-looking performance. It has chosen to respond to those forces within the Community that are most opposed to change and least interested in relations with the rest of the world.

CONFIDENTIAL

CONFIDENTIAL

-3-

The alternative of bypassing the Commission and dealing directly with the member states promises only limited satisfaction. We may, by working with those EC members that have views in common with us, be able to prevent the worst from happening. We should also encourage those states which seek positive reforms which enhance Atlantic solidarity. But, to turn useful ideas into reality, Commission leadership is still necessary. For a certain period, French-German hegemony within the Community could take its place. But at present there is no such leadership group of member states, and the combination of a weak Commission and a fissiparous bunch of member states leads to policy making of an unimaginative, lowest-common-denominator variety.

The current Commission's weakness is in part attributable to its composition. There are few strong personalities on the Commission. Its President, Gaston Thorn, appears incapable of dominating the Commission, or organizing an inner group that would run things, much less of having significant influence over the member states.

But what we see as weakness might be described by the Commission as realism. The Commission may well feel that, given the politico-economic circumstances of the Community, it is doing well simply to keep the Community together or that it is achieving something if it preserves free trade within the Community--even at the cost of damage to the international trading system and to the fundamental transatlantic relationship. The central objective of our efforts must be to make clear that preserving the Rome Treaty at the expense of the Alliance is neither a realistic nor a profitable alternative.

This brings us to the second and much more fundamental difference between the current situation and past periods of US-EC strife, the relative decline of the European economy and its ramifications for European attitudes.

For much of the history of US-EC relations, the economic performance of Europe was a source of pride and satisfaction - and sometimes envy - to this country. Indeed, U.S.-European tensions as at the beginning of the 1970's resulted in part from the U.S. belief that a prosperous and rapidly advancing Europe should play a more responsible and burden-shouldering role.

CONFIDENTIAL

CONFIDENTIAL

-4-

Since 1973 the story has been different. Europe is the only part of the world which has failed to create jobs: employment in the EC decreased by 3 million between 1973 and 1983, while in the U.S. employment grew by 15 million. These have been years in which the European economy has become more rigid, especially in terms of labor mobility; in which wages and unit costs of production have risen sharply, despite low growth, at the expense of profits and investment; in which Europe has fallen further behind the United States and Japan in terms of industrial and commercial exploitation of new technologies.

The well-publicized "Europessimism" reflects both an awareness of this process and a lack of belief that the problems of Europe's economy can be resolved or even managed. This point of view also argues that even if there is a cyclical upturn, Europe is doomed to relatively low growth and declining competitiveness over the middle and long term.

The European policy response to this pessimism tends to be a reversion to emphasis on increased regulation, organizing markets and protecting the current structure of industry and employment. The danger is that this will lead to the conclusion that since Europe cannot compete with the rest of the world, it must re-erect trade barriers. This, cloaked with additional justifications, is the theme of the British Labor Party's "Alternative Strategy" and is echoed to some degree in the recent French Government paper on technology and industry.

The economic doldrums have also had an effect on the mentalities of European politicians. In most countries, economic management has become the principal, time-absorbing concern, and it has also come to play an increasing role in consultations among the EC members. The effect on the European Community has been to intensify concern with issues such as budgetary contributions, and to lessen any tendency to take a broader, outward-looking view. The Community for its part, has done little to contribute to the resolution of the fundamental economic problems of Europe, with the qualified exception of the creation of the European Monetary System.

The conclusion is that managing our problems with Europe to achieve a mutually satisfactory outcome under present circumstances requires a far greater than usual dose of leadership, coordination and finesse on our side.

CONFIDENTIAL

CONFIDENTIAL

-5-

Specific Issues

While it would be a misleading exaggeration to say that US-EC relations are currently in a state of crisis, there is an abundance of serious differences between us which, if left unresolved could well grow to "crisis" proportions during the months to come.

There are two key areas of dispute in the trade field.

Agriculture. For some time, the functioning of the CAP has given rise to increasing complaints in the U.S., principally due to the impact on U.S. exports of growing production in the EC, and consequent surpluses which are dumped on the world market with the aid of Community subsidies. These concerns have been heightened by the current effort of the Community to reshape its agricultural programs and to deal with its budgetary problems (which arise from the conflict between growth in agricultural spending and the limitations on Commission revenue).

The EC Commission at the end of July came up with proposals that are vague and unconvincing with regard to limiting spending on agriculture, but specific about reducing the "problem" caused for the Community by duty free entry of soybeans and corn gluten feed (mainly from the U.S.).

Four of the member states, the UK, Germany, the Netherlands and Denmark, are dissatisfied with the Commission proposals, for a combination of domestic (opposition to more agricultural spending) and international (fears of the repercussions on US-European relations) reasons. Their opposition should be sufficient to block, or at the least modify, the fats and oil tax measures that would affect our soybean sales. We are less optimistic on the feedgrain substitute issue, as Community-wide pressure is building for some kind of compromise package that would include a tariff quota arrangement on corn gluten. In addition, unless the Commission proposals for the modification of the internal operations of the CAP are substantially improved, European agricultural production will continue to increase, and European competition with the U.S. in third markets will grow. It should be a major aim of U.S. policy, working primarily through those countries which are receptive to our arguments, to prevent the adoption of measures which threaten key U.S. interests and lay the basis for a longer term solution to the problem.

CONFIDENTIAL

CONFIDENTIAL

-6-

Steel. The carbon steel arrangement reached last October is under strain. The EC is upset because third country suppliers are seizing its former markets; we are worried that pipe and tube imports are too high; the proposed U.S. Steel-BSC slab steel deal also threatens the arrangement.

The EC viewed our import restrictions on specialty steel as a violation of the Williamsburg and OECD trade pledges. The EC is demanding speedy action on compensation and refuses to negotiate an orderly market arrangement. Talk of retaliation is again the order of the day in Brussels..

There are two other disputes which are not technically between the U.S. and the EC, but do involve the member states of the EC.

Export Administration Act. While the last two years have produced a narrowing of policy differences between us and the Europeans regarding East-West economic relations, long-existing European resentments over the extraterritorial application of U.S. law were newly aroused during last year's pipeline controversy, and have now focussed on specific provisions of the EAA now under discussion in Congress.

Unitary Taxation. For the Europeans, this is also an issue of "extraterritoriality." In this case, the European interest has been aroused by the recent Supreme Court decision on the Container Corporation case and by well-publicized intra-Administration discussions; it was on the top of Mrs. Thatcher's list for her Washington talks. The President's decision not to file an amicus curiae brief in the request for a Supreme Court rehearing of the Container Cooperation case was poorly received in Europe.

Finally, coloring the whole fabric of US-European relations is the continued strain over monetary policy and the international monetary system.

While the decibel level of official European complaints about the impact of U.S. policies on interest rates, the level of the dollar, and the stability of exchange rates has declined for the moment, the issues have not disappeared. Should European recovery continue to be halting and insufficient to bite into record unemployment levels, and should this unsatisfactory performance be accompanied by continued high

CONFIDENTIAL

CONFIDENTIAL

-7-

U.S. interest rates and continued heavy capital flows into the U.S., US-European differences in this area could again become acute, and could spill over into other aspects of the relationship.

Europe's Importance to the U.S.

If Europe is so badly off, why bother with it?

Despite its pessimistic frame of mind, economically Europe still counts for a good deal. While U.S. trade with Europe is a smaller share of our total trade than twenty years ago, it is still vitally important. Europe, even if its recent past and present have seen little economic growth, is an extremely wealthy area. While our investments in Europe have been relatively stagnant after their rapid growth in the 1950's and 1960's (and while flows in our direction are now more significant), our stake in European production and service industries remains enormous.

The political relationship is even more significant. The rise of Japan and the blossoming of some NICs have not changed the orientation of interest of the U.S. public significantly. Western European nations are generally viewed as more significant to the U.S. than any others, except for our next door neighbors, Mexico and Canada.

Perhaps most important, the security relations developed a generation ago remain at the center of our foreign policy. The deterioration of the U.S.-European security partnership would certainly destabilize the order we have expended much to establish, and which is essential for a balanced relationship between the West and the Soviet Union. The danger to U.S. security of such a process needs no elaboration.

All of this argumentation would be fatally flawed if Europe were embarked irreversibly on a downward spiral toward insularity and insignificance. Past prophecies to this effect, fortunately unfulfilled, should be warning enough against accepting such a judgment at face value. But, in addition to the argument that we must consider the impact on the security relationship of US-EC economic relations, is another contextual argument: that it is in our interest as well as Europe's to encourage it to take the steps to redress its economy, and remain open to the world while resuming the stalled progress toward greater unity.

CONFIDENTIAL

CONFIDENTIAL

-8-

A decade ago we argued that Europeans had to recognize the linkages between different areas of international relations: economic, political, and strategic. The argument was correct then and now, and most Europeans have come to accept it, at least on a theoretical level. The problem now, as in the past, is that they sometimes prefer to ignore it relative to certain economic, trade and extra-regional political issues.

It is difficult to conceive of an alliance that is wracked by internal trade wars continuing to be closely knit and effective in its political-military relationships. Obviously, the burden of maintaining the US-European relationship is a shared one, just as we share the economic, political and strategic interests that underly that relationship. But at the present juncture, with Europe suffering from a crisis of confidence, the U.S. has to carry more than its normal, or "fair" share of the responsibility for seeking resolution of the issues.

Conclusions

Looking at our economic relations with Europe in the broader context, and taking the initiative to resolve them, does not mean selling our commercial interests down the river, or doing innately stupid things in the name of transatlantic unity. On the other hand, it does mean that a vigorous and concerted effort must be made to broaden and enhance the relationship between the U.S. and the EC. Specifically, this has implications for both our internal efforts and our dealings with the Europeans.

Internal.

We should consider the impact not only of single actions, but of the accumulation of several actions taken at the same time, on the relationship. Agricultural trade, industrial trade, and monetary policy decisions tend to be taken separately and by different people within the U.S. Government, but their impact is felt as one by the Europeans. We need a better sense of strategy, and more coordination, in making our policy decisions that impinge on Europe. .

CONFIDENTIAL

CONFIDENTIAL

-9-

As a means of attaining this, the SIG/IEP should establish an interagency task force to evaluate our individual trade disputes with the EC in the light of overall U.S.-European relations and U.S. economic and commercial interests. The task force could also attempt to identify actions the U.S. could take to foster cooperation to resolve shared industrial problems, as in the case of steel. A key goal of the group would be to identify areas in which U.S. trade actions have not been consistent with overall objectives, as well as areas in which the U.S. should redirect its efforts in order better to support its broad objectives.

External

The goal of our external effort is to move the Europeans to recognize that just as they are trying to resolve their own internal problems in a package, which has both specific political content (enlargement) and a basic political goal (European integration), they must also view transatlantic economic relations in the context of our common political and security objectives. This effort will require several approaches.

As a backdrop to this strategy, we should reiterate our long-standing support for the European Community and its goal of unification, not as an abstraction but because (and hence, insofar as) it is a key element of Western security. Such statements, beginning at the highest level (which to date, this administration has not done) will both demonstrate that our interest in Europe has not flagged and recall that it is part of a larger, and equally historical design.

It also follows that we should take positive notice when the European Community does do something that can be seen as a positive action--and a contribution to its own unity should be seen as such, so long as the unity isn't achieved at the expense of others. Our record in the past has not been good on this. The EMS, which, if it led to common economic policies and a common currency, would contribute a great deal to European unification, was received rather negatively by the United States, even though it did not threaten us in any material way. Political cooperation between the EC member states has received a similar gingerly reception, particularly when it verges upon the strategic area. We should be prepared to take some minor risks in encouraging the Europeans to be risk-takers.

CONFIDENTIAL

CONFIDENTIAL

-10-

As concerns our diplomatic efforts, we should continue to hold discussions with the European Community that rise above the exchange of laundry lists of specific complaints; otherwise, adversary exchanges will become the sole substance of the relationship. Meetings of the sort held last December (and which will be repeated this December) between five U.S. cabinet officers and five EC Commissioners can do a good deal to put issues in better perspective.

Given the present enhanced importance of the member states on shaping EC policies, discussions between U.S. cabinet and sub-cabinet officials with their European counterparts should include the overall political theme as well as economic issues. U.S. officials should constantly urge the Europeans to see these issues as part of an integrated whole, of which our security relationship is a part. If we do not wish the Europeans to compartmentalize issues (and hence ignore the political dividends they gain by compromise), we must avoid doing the same.

Finally, we must apply this "blanket approach" to the issues at hand, particularly agriculture and specialty steel. This will mean a search for compromises in dealing with issues on as broad a front as possible. From our perspective, one basic fact has remained clear throughout all our disputes; an economically strong Western Europe is economically important to the United States. It is also clear that a real reform of the CAP would benefit Europe, by leading to a more efficient allocation of resources. Furthermore, some revision of the CAP is necessary to permit the incorporation of Spain into the EC--which is probably a necessary condition for continued Spanish membership in NATO. Finally, while a prolonged fixed-position defensive action by the United States is unlikely to succeed in maintaining our existing position in the EC market, it will surely put the overall relationship under great strains. It is time to consider a more flexible and positive approach.

The Europeans have reason to be receptive. An inward-looking solution is not in Europe's best interest, even if it could be obtained through a balancing of particular member state concerns. Internally, a jerry-built compromise sustaining, or even furthering, inefficient use of the Community's resources may not stand the test of expansion, or

CONFIDENTIAL

CONFIDENTIAL

-11-

in the long run, obtain the ever-increasing resources it will require. Externally, Europe would gain little by a "solution" that erodes the basic foundation its unity has always had in the Atlantic Alliance.

While the steps to such a compromise will have to be taken on both sides, only the United States can initiate the process. We will have to demonstrate our willingness to be flexible with concrete proposals. From our point of view, the ultimate bargain should be as comprehensive as possible. In agriculture it should cover production issues, as the roots of the subsidies issue, as well as more immediate issues of prices and trade barriers. Further, although we might not wish to link the substance of agricultural and steel issues, there is a clear linkage between how we are handling EC requests for compensation on specialty steel and the manner in which they are likely to pursue their agricultural goals which we should not overlook, at least in formulating our own tactics.

The various possible permutations for comprehensive agreement are beyond the scope of this paper. One example might be cited, as a possible means for us to open such a dialogue. If the judgment is made that restraints on corn gluten exports to the EC are inevitable, we may want to formulate an offer whereby we get something in return for U.S. restraints. One scenario might be for the EC to offer to limit the gap between internal and world grain prices. This would be a logical trade since the effect of such steps by the EC would be to narrow the EC market for non-food grain imports.

CONFIDENTIAL